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10 April 1984

MEMORANDUM FOR THE RECORD

SUBJECT: East European Financial Conference

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On 21-23 March the East Europe Division of the Office of European Analysis and the Office of the USSR and Eastern Europe at the US Department of Commerce sponsored a conference on East European economic, trade, and financial prospects [redacted] The invitees included over 40 experts on Eastern Europe from academia, private banks, and other government agencies, along with numerous attendees from Commerce and the CIA (See Attachment A).

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The conference was divided into 6 substantive sessions with two opening keynote addresses (See Attachment B). Though no attempt was made to reach a consensus on particular issues or to draw formal conclusions, the following appear to represent the major areas of agreement.

-- The East Europeans have substantially improved their hard currency trade and payments performance over the past two years, but mainly through import cuts rather than export growth. External adjustment has resulted from short-term, ad hoc measures that have depressed economic growth, and the regimes have not undertaken the structural changes needed to sustain economic recovery.

-- Financing should pick up in the near-term, allowing some easing of import restraints, but credit flows will remain at levels well below the peaks of the 1970s and continue to be influenced by political events.

-- Eastern Europe will likely lose ground to competitors in its hard currency export markets, preventing substantial increases in imports from the West.

-- Though CEMA has changed little the past 25 years the pressures are growing for change. The initiatives under consideration at present, however, are not to the advantage of Eastern Europe.

-- The US proclaims an interest in differentiating Eastern Europe from the Soviet Union and even differentiating

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among the East European countries, but policy measures in this area are weak, and there is no clearly stated US policy towards Eastern Europe.

-- The ability to assess the East European economies is becoming more difficult due to a lack of data for several of the countries and the possibility that the published statistics for some countries no longer accurately reflect what is happening.

Following are brief summaries of the individual sessions.

Keynote Speakers

The conference kicked off with an address by Olin L. Wethington, Deputy Under Secretary for International Trade. Mr. Wethington's view of Eastern Europe--that of "guarded optimism"--was a theme expressed by other speakers over the following two days. While the West European economic recovery and increased banker confidence will allow for some improvements in 1984-85, he believed Eastern Europe still must overcome many long-term difficulties, including weak export performance and the absence of systemic reforms. He concluded with the three issues of most concern to the Department of Commerce (DOC).

-- Export Controls. The dilemma is weighing the need to control US exports on national security grounds against the reality that many controlled items are available outside the US and even produced within the bloc itself.

-- Import Relief Laws. Regarding anti-dumping cases, it has proven difficult to determine the degree of subsidization in nonmarket economies.

-- Countertrade. While the USG does not support countertrade, the DOC, nonetheless, needs to help provide information to US firms because it is playing an ever greater role in trade with Eastern Europe.

Dr. Norman Bailey of International Business-Government Counsellors, Inc. followed with a lively--and controversial--discussion of the world debt crisis. In his view, the current debt crisis stems from policies that overinflated the US economy and thus debased the US dollar. The crisis already has gone through two phases--the initial phase of deepening financial problems that culminated in Poland's inability to pay its debts, followed by a period of ad hoc solutions including numerous financial conferences and multiple reschedulings. Dr. Bailey sees the world entering a third phase in which some new arrangements must be made. If not, we are likely to see unilateral debt moratoriums and repudiations and even the possibility of a debtors' cartel. Among Dr. Bailey's solutions are longer term reschedulings, secondary markets for rescheduled loans, and the exclusion of trade credits from reschedulings.

Most of the discussion that followed focused on the lack of leadership to take control and initiate these new arrangements.

East European Convertible Currency Prospects

The Thursday morning session began with [redacted] CIA STAT
presenting highlights from the unclassified version of the East European debt crisis paper. [redacted] noted the recent STAT
favorable press treatment accorded Eastern Europe, treatment that is not entirely undeserved given recent economic performance. Yet he noted that numerous problems remain for a number of countries. Lending to the region will increase, but Eastern Europe no longer will receive the favorable terms of the 1970s and bankers will quickly respond to any perceived changes in the political climate. He concluded by summarizing the outlook in each of the countries.

-- Poland's problems are likely to continue with the regime committed more to pacifying consumers than instituting serious adjustment and stabilization measures.

-- Romania's financial turnaround has been dramatic and Bucharest is likely to avoid rescheduling this year, but the domestic economy has suffered greatly and financial difficulties could arise again as early as 1985.

-- Last year's rescue package was a great help to Yugoslavia, but Belgrade has yet to correct fundamental weaknesses in its economy and further packages will be needed.

-- While Hungary has been able to raise sizable loans due to its favorable image among bankers, Budapest's financial position still is troubled by a large debt, a significant amount of short-term borrowing, and weak export performance outside of CEMA.

-- East Germany's improvements are hard to verify given numerous data problems and may be due in large measure to the West German financial umbrella.

-- Both Bulgaria and Czechoslovakia have avoided serious financial difficulties recently but are not immune to the problems endemic to centrally planned economies.

Don Green of Chase Manhattan spoke next on behalf of the international banking community. Dr. Green essentially followed up on Dr. Bailey's idea that the next stage of rescheduling needs new financial ideas, including indexing, negotiable instruments and semi-equity schemes. He noted, however, that with the exception of Poland, Eastern Europe's financial difficulties are negligible compared to those of the LDCs and therefore innovations in rescheduling, except for Poland, are likely to arise elsewhere.

Adjustment Measures and Growth Potential

Dr. Jan Vanous of Wharton Econometric Forecasting Associates began the afternoon session and concentrated on how the East Europeans have reacted to the credit squeeze and worsening terms of trade with the Soviet Union. Initial policies focused on sharp investment cuts, first in inventories and then in the funding of unfinished projects. More recently the focus has shifted to reducing living standards. He concluded by giving brief country surveys with the most interesting points being that any evaluation of East Germany is severely hampered by the lack of official data and that in the case of Romania we can no longer believe official statistics.

Dr. Thomas Wolf of Ohio State University also discussed recent adjustments but largely in terms of traditional macroeconomic theory. He contrasted the East European approach with that of market economies by noting that East European planners have reacted by simply closing the door on imports and investments. He argued that these policies have yielded short-term benefits, but do not bode well for long-term growth prospects. He suggested that finer tuning is needed and that sustainable improvements will require the introduction of market mechanisms.

Dr. Paul Marer of Indiana University primarily discussed the relationship between adjustment and economic reforms. He stated that the extensive factors of development--such as growing amounts of Soviet assistance and Western credit flows--which fed growth from the 1950s to the 1970s no longer exist and that future growth must come from economic reforms. Yet opposition to reforms remains strong throughout much of the region and even if reforms began soon, they would generate few rewards in the near-term. He said that only Yugoslavia and Hungary have sought to differentiate their economies from the rest of the region, but they have introduced reforms for different reasons. Yugoslavia's worker's self-management is the result of the initial break with the Soviet Union and Tito's policy of decentralization to satisfy regional interests. Hungary's reforms have been the result of a relatively more liberal political climate which has fostered debates and allowed for an environment more amenable to reforms. The reform has proved most effective in agriculture and small-scale activities, but it is too early to assess the impact in the industrial sectors. He concluded that the Hungarian model has achieved some good results--and some lessons can be learned by the rest of Eastern Europe--but there are still many shortcomings.

The session ended with a talk by Dr. Elizabeth Goldstein of the Federal Reserve Bank of New York on the role the International Monetary Fund (IMF) has played in Eastern Europe. Dr. Goldstein argued that the role of the IMF has been to improve the payments performance of these countries not to implement structural changes. Given recent financial improvements, the IMF has done its job. The IMF--and especially the World Bank--can play a role in helping these economies introduce needed structural changes, but only if the governments support the policies. According to Helen Junz, a member of the IMF, Romania and--to a lesser extent--Yugoslavia have not shown much willingness to make such changes, while Hungary is making some progress.

East European-Soviet Economic Relations

One of the two evening sessions looked primarily at CEMA, with Ed Hewett of Brookings Institution, Keith Crane of Rand Corporation, and [redacted] of CIA as the panelists. The STAT group concluded that little has changed in CEMA since its inception over 25 years ago but that pressures for change are growing. From the East European side, the current financial crisis has sparked renewed interest in substituting CEMA goods for hard currency goods. The Soviets, however, see current CEMA trade relations as a drain on their economy and therefore seek changes. Exactly what direction CEMA will take is not entirely clear. The terms of trade have been changing to the advantage of the Soviet Union, and Moscow is likely to pursue policies that will see this continue. But Moscow also sees increased integration as needed within CEMA, a move that most of the East Europeans wish to avoid for both political and economic reasons.

What East European Prospects Mean for the West

The other evening session opened with a view of Eastern Europe as seen by a European banker, Ivor Coffin of Lloyds Bank of London. Mr. Coffin noted that bankers often make loans on the basis of "gut" feelings although various statistics also play a part. These gut feelings were favorable to Eastern Europe in the 1970s, primarily due to the "umbrella theory" and belief in the ability of centrally planned economies to respond quickly to financial problems. The 1980s saw an "inverted umbrella" as bankers chose to pull out en masse. At present bankers are marking time, keeping enough money in Eastern Europe to maintain working relationships.

[redacted] of CIA followed Mr. Coffin and presented his STAT findings on the economic importance of Eastern Europe to Western Europe. Despite all of the talk about the important economic relationship, [redacted] found that the statistics do not STAT support this argument. West European exports to Eastern Europe are only a small percentage of total exports and are well diversified. Moreover, the impact on employment also is small, even for the most widely traded items. There exist perhaps a few depressed industries where employment is crucially tied to the East but even then the percentage of the total work force is insignificant. He felt the attachment is more political than economic, with the West Europeans believing that good trade relations help ease political tensions.

The evening ended with a lively discussion of GDR-FRG relations. Hanns Jacobsen of the American Institute for Contemporary German Studies believed that the ability of the East Germans to put their financial house in order and to revive domestic economic growth last year stemmed from two factors. The first is the West German economic umbrella which he feels "runs deep." Nonetheless, he feels that there is a fear in East Germany of becoming too closely tied to the FRG and that soon the East Germans will "pull back" and seek to expand trade elsewhere. The second factor is East German pride. Mr. Jacobsen argues that East Germans lack a national identity since they really don't identify with their communist leaders. But they do feel that by working hard and improving their standard of living, they can set themselves apart from the rest of the bloc. This notion was seconded by Mr. Stan Rudchenko of Bankers Trust of London who feels that last year's economic successes were the result of East Germans simply "responding to the challange."

Outlook for Trade

The Friday morning session opened with a panel consisting of John Garland of the University of Kansas, Allen Lenz of the Department of Commerce and Paul McCarthy of Chemical Bank of New York. The group generally agreed that the trade outlook was not encouraging and listed a variety of factors they felt would constrain East-West trade, including

-- financing difficulties due to bankers' unwillingness to plunge back into the region;

-- continuing excess capacity in Western Europe in areas in which the East Europeans hope to compete;

-- growing protectionist sentiment in the West; and

-- increasing competition from the LDCS, especially their ability to produce higher quality goods due to better entreprenurial climate and Western direct investment in their economies.

Mr. McCarthy concluded on the rather somber note that Eastern Europe soon may find itself more vulnerable financially than it did 18 months ago. His argument is that most bankers are going to shy away from the large syndications that were so common a few years ago. Thus most activity will involve short-term credits which will grow as a percentage of outstanding debt, leaving the region more susceptible to pullouts by bankers. Despite the somewhat improved attitudes of bankers, they now attatch a higher level of risk to East European loans than they did in the 1970s and will withdraw credits at the slightest indication of trouble.

Issues and Options for Western Governments, Financial Institutions, and Business

The final discussion of the conference focused most of its attention on what lay ahead in East-West relations and--in particular--what it means for the US. The panel consisted of Richard Portes of the Centre for Economic Policy Research in London, Stan Rudchenko of Bankers Trust of London, John Hardt of the Library of Congress and Roland Kuchel of the Department of State.

Mr. Kuchel spelled out US policy toward the region as one which hopes to promote human rights and economic reforms, loosen the region's dependency on the Soviet Union, and expand US trade. He said this policy was pursued using economic, political, scientific and cultural exchanges with the area. But Mr. Kuchel, along with the rest of the panel, noted that this policy has often been inconsistent and poorly executed. The lack of a well-defined program towards Eastern Europe has irked the West Europeans. In particular, US vacilations on economic matters is most vexing to our allies who view closer economic relations as necessary to ease political tensions. Dr. Portes perhaps best summed up this conflict by commenting that the West Europeans have vision but no policy while the US has a policy but no vision. For example, he said the key question the US has yet to answer is whether or not a weak Soviet economy is to the advantage of long-term US interests. To the West Europeans, however, the issue is clear as they argue that "trade makes friends." The conference essentially came full circle as the discussion ended with a return to the various trade issues facing the US that Mr. Wethington described on opening night. Mr. Hardt discussed pending legislation affecting Eastern Europe such as the Trade Remedies Act and changes to the Jackson-Vanick Ammendment. He concluded that, at present, there is little prospect for any dramatic changes.

Attachments:
As stated

Attachment A

SYMPOSIUM PARTICIPANTS

Private

Name	Representing
Crane, Keith	Rand Corporation
Garland, John	University of Kansas
Hewett, Ed	Brookings Institution
Marer, Paul	Indiana University
Portes, Richard	Centre for Economic Policy Research
Wolf, Thomas	Ohio State University
Hasfurther, Donald	US Chamber of Commerce
Jacobsen, Hanns D.	American Institute for Contemporary German Studies
Vanous, Jan	Wharton Econometric Forecasting Associates
Baranetsky, Walter	Morgan Guaranty Trust
Coffin, Ivor	Lloyds Bank (London)
Craft, Alan	Chase Manhattan
Eichler, Gabriel	Bank of America (Frankfurt)
Green, Donald	Chase Manhattan
McCarthy, Paul	Chemical Bank
Minneman, John	Chase Manhattan
Richards, Robert	Manufacturers Hanover
Rudchenko, Stan	Bankers Trust (London)
Shaw, Karen	Bank of America (Washington, D.C.)
Sweet, Lawrence	Marine Midland
Tuerk, Michael	American Security Bank
Bailey, Norman	International Business-Government Counsellors, Inc.
Fehr, Gisela	Marine Midland
Duryer, Mary M.	Morgan Guaranty Trust

Other

Goldstein, Elizabeth	Federal Reserve Bank of New York
Junz, Helen	IMF

SYMPOSIUM PARTICIPANTS

US Government Participants Other than CIA

Cooper, William	Library of Congress	Brougher, Jack	Commerce	
Danylyk, John	State	Burgess, Jay	Commerce	
Dobriansky, Paula	NSC	Earnshaw, Donald	Commerce	
Dwight, Ronald	State	Ellis, James	Commerce	
Fleig, Joseph	Export Import Bank	Fogarasi, John	Commerce	
[redacted]		Fulton, Edgar	Commerce	STAT
		Gallagher, Robert	Commerce	
Hardt, John	Library of Congress	Good, Alexander	Commerce	
Hauser, Tim	State	Haggerty, Susan	Commerce	
Kaufman, Richard	Library of Congress	Harrod, Dolores	Commerce	
Kuchel, Roland	State	Jackson, Geoffrey	Commerce	
Malish, Tony	Agriculture	Jurew, Karen	Commerce	
McGonagle, Paul	State	Kolarik, William	Commerce	
Miller, David	State	Liikala, Michael	Commerce	
Peters, Many-Ann	State	Lotarski, Susanne	Commerce	
Price, Janice	Treasury	Lenz, Allen	Commerce	
[redacted]		Martens, John	Commerce	STAT
Shapiro, Harvey	Treasury	Vargo, Franklin	Commerce	
Tomlinson, Kate	ITC	Gillula, James	Commerce	
Vankai, Thomas	Agriculture	Heiss, Hertha	Commerce	

Attachment B

Agenda

EAST EUROPEAN ECONOMIC, TRADE AND FINANCIAL PROSPECTS

Sponsored by the US Department of Commerce and the
Central Intelligence Agency

March 21-23, 1984
[redacted] STAT

Wednesday, March 21

4:30 - 6:00 p.m. Arrival and registration

6:00 p.m. Cocktails and dinner

Keynote Speakers: Dr. Norman Bailey
International Business-Government
Counsellors, Inc.

Olin L. Wethington
Deputy Under Secretary
for International Trade

Thursday, March 22

7:30 - 8:30 a.m. Breakfast

9:00 Welcome and introductory remarks

9:15 - 12:00 East European Convertible Currency Prospects
Current financial situation and outlook; credit worthiness; lending attitudes of Western banks and governments; rescheduling experience and debt management.

Panelists: [redacted] CIA STAT
Gabriel Eichler, Bank of America (Frankfurt)
Donald Green, Chase Manhattan Bank

12:30 - 1:30 Lunch

2:00 - 5:00 Adjustment Measures and Growth Potential
Adjustments to financial constraints--policies and impact on domestic economies and future policy options; short-term adjustments vs. systemic reforms; role of IMF.

Panelists: Jan Vanous, Wharton Econometric Forecasting Associates,
Paul Marer, Indiana University
Elizabeth Goldstein, Federal Reserve Bank of New York
Thomas Wolf, Ohio State University

Agenda

Thursday, March 22 (cont.)

6:00 - 7:00 p.m. Dinner

7:30 - 9:00 Group Discussions:

1. East European-Soviet Economic Relations
   Panelists: Ed Hewett, Brookings Institution
   Keith Crane, Rand Corporation
   [redacted] CIA STAT

2. What East European Prospects Mean for the West
   Panelists: [redacted] CIA STAT
   Ivor Coffin, Lloyds (London)
   Hanns Jacobsen, American Institute for Contemporary German Studies.

Friday, March 23

7:15 - 8:15 a.m. Breakfast

8:30 - 10:15 Outlook for Trade
Impact of adjustment measures on hard-currency earnings capabilities; East European competitiveness; changes in direction of trade; countertrade.

Panelists: John Garland, University of Kansas
Allen Lenz, Department of Commerce
Paul McCarthy, Chemical Bank

10:30 - 12:30 Issues and Options for Western Governments Financial Institutions, and Business

Panelists: Richard Portes, Centre for Economic Policy Research (London)
Stan Rudchenko, Bankers Trust (London)
John Hardt, Library of Congress
Roland Kuchel, Department of State

12:30 - 1:30 Lunch and departure